

INDECK KEYSTONE ENERGY LLC V. VICTORY ENERGY OPERATIONS LLC

Financial Overview  
Of

Boilers Sold by VEO during the term of the License with IKE & The VEO Voyager Contracts

Indeck Keystone License Agreement Package Boilers

Attached are the following summary reports:

Summary of Contracts Reviewed  
Summary of Profit/Loss for Contracts Reviewed  
Summary of Job Costs

I worked for Zurn Energy Division, formally Erie City Iron works, for 34 years, starting in 1961 and retiring in 1995. Since that time I worked for Copes Vulcan for approximately four years and from time to time worked as an independent consultant. For 17 years of my time at Zurn, I held the position of Project Manager. A large part of my responsibilities involved insuring the profitability of the projects for which I was responsible. This involved keeping track of all material, engineering, shop costs and any other costs expended on each project. These costs are compared to the budget cost estimate that was prepared initially by the sales department to determine the selling price for the project. By doing this on a continual basis throughout the execution of the contract, it is possible to determine that the project is on track to maintain the level of profitability expected, or at least make timely adjustments to keep the profitability as close as possible and still meet the commitments of the contract.

The attached are summaries of the contracts that we are aware of involved in this litigation concerning the construction of certain products during the term of the License Agreement between IKE and VEO. We have reviewed the documents submitted by VEO. Using the best information we can obtain from these documents, we have derived a profit /loss for each of these contracts as indicated in this summary. We have based the profit/loss on the Royalty Base price as indicated on the "Unit Sales Notification Letters" submitted by VEO, because the license agreement only covered the basic boiler and not the ancillary equipment or any of the necessary interconnecting piping, wiring, ductwork, etc.

These types of contracts are normally bid competitively. The typical first step is to estimate costs and add a profit margin to arrive at a bid price. Then it is also normal practice in the industry to determine the profit of a product by deducting all the actual associated costs from the selling price of the product. The remainder is the profit. These costs would consist of material, labor, freight, commissions, shop overhead, and any applicable administration costs. I have been advised of law in Pennsylvania which indicates that indirect costs should not be subtracted from profit calculations, in certain lawsuits. Because the court has not yet ruled on the applicability of that law in this case, calculations are being provided in the alternative.

The following are some comments and inconsistencies that were made in reviewing the documents as submitted.

1. The original submittal included a list of the contracts that were sold and completed under the license during the specific time period in question. Contract No. 313 was listed, however this contract was not included in any of the financial reports submitted. There is not sufficient information available to determine any profit or loss on this specific contract. I have, however, subsequently been advised that contract 313 is not a part of the pending claims. Therefore, I will not give further consideration to that project.

2. We have received two different submittals of the following reports. The first was with the original submittal in mid September, the second on October 6, 2006:

- a. Statement of Gross Profits for Selected Jobs
- b. Cost of Goods Manufactured for Selected Jobs
- c. Direct Labor Calculation
- d. Manufacturing Overhead Rate Calculation for FYE 12/31/05
- e. " " " " for Qtr End 3/31/06
- f. " " " " for Qtr End 6/31/06
- g. Selling & Administrative Salaries

All of the reports in both submittals are dated as "job to date as of 08.31.06". It is noted however, that some of the values differ in all reports except for c. &g. The values in the second submittal that are different are higher, even though they are dated the same date. This brings into question the credibility and the validity of these reports.

3. In regard to direct labor man-hours and direct labor costs, there are seven different reports showing these. In most cases these values are not consistent from report to report. As an example the following values can be found for Job No. 418:

Job Transaction Detail	? MH	\$9923
Statement of Gross Profit*	? MH	\$120,461
Cost of goods Manufactured*	8576.82MH	\$120,461
Direct Labor Calculation*	7976.82MH	\$120,461
Cost Code By Individual 1/1/04 to 8/1/06	7976.8MH	\$116,881
Cost Code By Job	7231.8MH	\$103,504
Weekly Time Sheets	5446.15MH	\$??

As noted previously, this is another example of the inconsistencies in the data presented and undermines the reliability of this data.

\* These are titles of reports that were submitted by VEO.

\*The Statement of Gross Profit lists the contract price and deducts the material, labor, overhead and other allocated costs to arrive at a profit/loss for the each of the contracts.

\*The Cost of Goods Manufactured Report is a summary of the material, direct labor, manufacturing overhead and other allocated costs for the various contracts. These are the values that were used in the Statement of Gross Profit Report.

\*The Direct Labor Report lists the regular and overtime hours worked on each of the contracts, along with the dollar value of those hours worked.

4. The labor hours are not defined as to the specific operation on which they were expended. Many of these man-hours could have been expended on operations that were not associated with the basic boiler. While we used the most repeatable direct labor man-hours and direct labor costs, it is very possible that these values are too high for determining the profit/loss on the Royalty basis price. Based on my experience, the direct labor hours should be tracked by the specific operation on which they were expended.

5. In the Statement of Gross Profits Report there is an entry for "other allocated costs." There is no back up to determine the basis for this expense.

6. According to the Statement of Gross Profit Report, VEO had a net loss of \$749,073 on the 11 contracts that are included in the report. This leads to the question as to why they would continue to sell this product if they couldn't make a consistent average profit.

7. We have requested a budget estimate for these jobs, but have not received these. We are told that they do not maintain these budget estimates prior to bidding a contract. It is difficult to imagine how they can arrive at a reasonable selling price without making a budget estimate of the various materials and labor operations that are required to complete the contract. The other boiler manufacturers that I am familiar with prepare a budget estimate. This is a complete summary of all the various materials and labor operations required and the overhead and administrative costs required to supply the product they are selling. Then an estimate of the cost of each of these components is assigned, along with a profit amount, to arrive at selling price.

8. VEO has an average manufacturing overhead rate of 270% of the average direct labor rate. This rate is not out of line for a boiler manufacturing facility. I do think, however, that it is high for the type of facility at VEO. Based on the copies of the purchase orders provided by VEO, they are basically an assembly facility. VEO manufactures very few, if any, of the many components that make up the finished product that they sell. They do not require the tremendous initial capital investment to purchase, install and maintain the equipment and machinery to actually form the

basic components of the boilers. This would include such machinery required for heavy metal plate rolling and welding, stress relieving furnaces, tube hole drilling, tube bending and the sheet metal fabrication. These operations are all out sourced.

9. As set forth in the attached Summary, VEO's profit on Keystone Boilers is somewhere between \$1,855,872 and \$2,293,765.

Victory Energy Operations Voyager Series Package Boilers

We have received a list of nineteen different contracts for a total of 42 Voyager Package Boilers sold by VEO.

The only documents that we have received are for the five contracts that have actually shipped from their assembly facility. These documents consist of the following;

- Job Billing History Report
- Job Transaction Detail Report
- Vendor Purchase Order Index (it does not include all of the purchase orders)
- Copies of Vendor Purchase Orders

We have not received the same reports and documentation that was furnished with the Keystone boilers built by VEO during the term of the Licensing Agreement with Indeck Keystone Energy.

The information contained in documents we did receive for the Voyager boilers is not sufficient to fully analyze these contracts with respect to their profitability.

The following is a table using the limited information that we have received

SUMMARY OF VOYAGER SERIES BOILERS SHIPPED

(see revised  
table on  
amended report)

\* The only indication of costs for these five contracts is on the Job Transaction Detail Report. Based on the information furnished with the Keystone units, these may or may not be reliable or complete

\*\* The Job Transaction Detail Report for this contract indicated that this contract is only 53% complete.

Order No.	Selling Price	Cost *	Profit	Equipment
443	\$2,103,002	\$2,112,433	(\$9,431)	(2) 150,000 PPH
444	\$642,339	\$533,170	\$109,169	(1) 85,000 PPH
445	\$642,339	\$674,332	(\$31,993)	(1) 86,000 PPH
* 504	\$1,552,328	\$537,406		(1) 120,000 PPH
515	\$2,528,525	\$2,087,346	\$441,179	(2) 150,000 PPH
Total	\$7,468,533			

Using the two profitable jobs we can estimate their percentage of profitability:

Job No. 444 \$109,189 estimated profit =17.0%  
\$642,359 contract price

Job No. 515 \$441,179 estimated profit = 17. (Superceded by amended report 4/30/07)  
\$2,518,525 Contract price

Using an average of these two contracts, the expected profitability of the five jobs shipped should be:

\$7,468,533 total Selling Price of the five contracts shipped x 0.1725 = \$1,288,321

With proper estimating to determine a realistic selling price, and proper contract management in the execution of the contracts, VEO should be able to improve this level of profitability as they gain more experience building the Voyager Boilers. Therefore the remaining boilers they have on order should be even more profitable.

The average profitability obtained on the Keystone units was 27%. It would be reasonable to expect that with their experience on these Keystone Boilers, they should be able to maintain the same level of profitability on the Voyager Boilers. If they did maintain this level of profitability on the Voyager boilers, the profit would have been  $\$7,468,533 \times 0.27 = \$2,016,404$ .

It is again necessary to point out the lack of sufficient information provided, and the question the credibility of the information received due to the inconsistencies contained in the documents that were received. This applies both to the Keystones built during the term of the License and the Voyager Series Boilers

/s/  
William F. Liebel

Rev. 4/30/07

**SUMMARY OF PROFIT/LOSS OF CONTRACTS REVIEWED**  
 (revised to include field costs 4/29/07)

VEO	Boiler Price	Misc	Direct	Material	Field	Direct Boiler	Shop	Mfg	Other Alloc	Total	Profit	Profit w/o Alloc Costs	Profit w/o AC & Mfg OH	Equipment
Job No	per Royalty	Expenses	Labor \$	Costs	Costs	Costs	Manhours	Overhead	Costs	Cost				
282	\$454,400	\$69,756	\$23,807	\$146,712		\$240,275	2,979.14	\$121,996	\$37,260	\$399,531	\$54,869	\$92,129	\$214,125	(1) 15M w/SH
303	\$395,440	\$24,627	\$31,380	\$103,100		\$159,107	2,327.00	\$95,291	\$30,828	\$285,226	\$110,214	\$141,042	\$236,333	(1) ?
313	\$816,800					\$0		\$0	\$0		\$0	\$0	\$816,800	(1) 8M &(2)14M
344	\$236,337	\$15,935	\$35,290	\$86,761		\$137,986	2,199.00	\$90,049	\$15,678	\$243,713	(\$7,376)	\$8,302	\$98,351	(1) 8M
347	\$345,000	\$31,398	\$30,651	\$86,023		\$148,072	2,312.24	\$94,686	\$15,757	\$258,515	\$86,485	\$102,242	\$196,928	(1) 15M
355	\$1,241,099	\$150,880	\$66,020	\$208,202		\$425,102	4,184.55	\$171,372	\$148,652	\$745,126	\$495,973	\$644,625	\$815,997	(2) 15M
356	\$269,211	\$20,131	\$64,491	\$127,621		\$212,243	4,149.00	\$169,902	\$9,576	\$391,721	(\$122,510)	(\$112,934)	\$56,968	(1) 15M
380	\$425,000	\$59,509	\$76,529	\$156,679		\$292,717	4,810.00	\$195,247	\$6,727	\$494,691	(\$69,691)	(\$62,964)	\$132,283	(1) 15M w/SH
390	\$439,924	\$53,476	\$42,585	\$116,625		\$212,686	2,598.00	\$102,513	\$81,605	\$396,804	\$43,120	\$124,725	\$227,238	(1) 15M
400	\$501,792	\$49,768	\$53,593	\$60,183		\$163,544	3,257.00	\$140,947	\$31,202	\$335,693	\$166,099	\$197,301	\$338,248	(1) 12M
410	\$1,535,177	\$145,340	\$128,800	\$321,386	\$51,146	\$646,672	8,577.00	\$330,269	\$37,396	\$101,4337	\$520,840	\$558,236	\$888,505	(2) 22M
418	\$1,229,932	\$119,744	\$120,461	\$252,471		\$492,676	7,976.80	\$312,093	\$6,891	\$821,660	\$408,272	\$425,163	\$737,256	(2)15M & (1)8M
<b>TOTAL</b>	<b>\$7,890,112</b>	<b>\$740,564</b>	<b>\$673,607</b>	<b>\$1,665,763</b>		<b>\$3,131,080</b>	<b>45,369.73</b>	<b>\$1,824,364</b>	<b>\$431,572</b>	<b>\$5,387,016</b>	<b>\$1,885,872</b>	<b>\$2,289,765</b>	<b>\$4,759,032</b>	

Misc Expenses and Material Costs are taken from the "Job Transaction Detail". See Job Expense Summary

Direct Labor costs and manhours were used from the most repeatable values obtained from the various manhour reports submitted

Because of the discrepancies in the different labor reports, I used the values for manhours and dollars that occurred most frequently.

Manufacturing overhead was taken from the break down on the "cost of Goods" report

The values for "Other Allocated Costs" were arrived at by using the value in the "Statement of Gross Profit Report" and multiplying it by the ratio of the Royalty Basis Price to the total selling price.

Manufacturing overhead includes all of the indirect cost involved in providing and maintaining a manufacturing facility. These costs include building costs, employee benefits, consumable materials, tools, insurance, taxes, maintenance, utilities, etc. All of these indirect costs are totaled up for a specific period and divided by the manhours expended for the same period. This gives a cost per manhour. This cost is then multiplied by the manhours on a specific contract and added to the total job cost.

The "Other Allocated Costs" expense was included in the "Statement of Gross Profit" report supplied by VEO. An explanation and/or backup for this expense was requested, but never received. The profits were calculated with and without this expense. Since there is no backup for these expenses, I do not feel that they should be included as an expense. This profit is shown in the column "Profit w/o Allocated Costs"

INDECK KEYSTONE ENERGY LLC vs. VICTORY ENERGY OPERATIONS LLC  
Amendment to Original Report

Voyager Series Profit Review

We have summarized in the attached table VEO Proposal and the Customer's Purchase Order selling prices. We have also included the expected range of profit that should be realized.

We have included a revised table showing the shop and field costs for the five Voyager orders that have been shipped. These revisions are based on the documentation received on April 25, 2007. This documentation included copies of purchase orders issued for material and labor required to complete the installation at the customer's site.

A 24.7% profit margin was used for the minimum expected profit. This was the profit realized on the three profitable contracts that have been completed and shipped.

A 27.5% profit margin was used as the Maximum expected profit. This was obtained from the average profit realized from the Keystone Boilers that were built during the term of the License Agreement between IKE and VEO.

I have reviewed the document "Defendants Amended Pretrial Statement". On Page 27, it is stated that VEO expected a profit of \$424,299 on a contract of \$1,697,197. This is an expected profit margin of 25%. This relates very closely to the margins that have been calculated from the documentation submitted for the Keystone Units and the Voyager Units.

Based on these values, the expected profit on these nineteen contracts should be somewhere between \$11,421,053 and \$12,715,747. It would be expected that the profits on these contracts should increase as VEO gains experience in manufacturing the Voyager Series package boiler.

/s/

William F. Liebel

4/30/07

## SUMMARY OF PROFIT/LOSS OF VOYAGER BOILERS SHIPPED

(Revised to include Field Costs)

Order No.	Selling Price	Shop Costs	Field Costs	Total Cost	Profit
443	\$2,103,002	\$2,112,433		\$2,112,433	(\$9,431)
444	\$642,339	\$533,170		\$533,170	\$109,169
445	\$642,339	\$674,332	\$54,267	\$728,599	(\$86,260)
504	\$1,552,328	\$829,705	\$53,187	\$882,892	\$669,436
515	\$2,528,525	\$2,087,346	\$54,392	\$2,141,738	\$386,787

Profit on the three profitable contracts **\$1,165,392** 24.7 Percent  
**\$4,723,192**

Job No	Customer	Proposal Sell Price	P.O. Sell Price	Minimum Profit	Maximum Profit	Equipment
446	Summit Ethanol	\$1,596,360	\$1,596,360	\$394,301	\$438,999	(2) VS-5-80 120,000#/hr 250psig Sat.
490	Premier Ethanol	\$1,596,360	\$1,596,360	\$394,301	\$438,999	(2) VS-5-80 120,000#/hr 250psig Sat.
502	Conestoga Energy	\$1,762,758	\$1,765,758	\$436,142	\$485,583	(1) VS-6-92 150,000#/hr 250psig Sat.
503	Conestoga Energy		\$3,096,000	\$764,712	\$851,400	(2) VS-6-92 150,000#/hr 250psig Sat.
508	Reo Technical	\$1,897,930	\$1,897,930	\$468,789	\$521,931	(3) VS-2-45 40,000#/hr 250psig Sat.
517	White Energy	\$3,185,400	\$3,185,400	\$786,794	\$875,985	(2) VS-6-92 150,000#/hr 250psig Sat.
528	GreatPlainsEthano	\$1,927,077	\$1,927,077	\$475,988	\$529,946	(3) VS-4-68 85,000#/hr 250psig Sat.
540	Cilion Inc.	\$13,637,125	\$9,920,937	\$2,450,471	\$2,728,258	(11) VS-4-68 79,280#/hr 450psig SH
541	Hennepin Energy	\$3,694,382	\$3,694,382	\$912,512	\$1,015,955	(2) VS-7-116 205,000#/hr 250psig Sat.
542	Ultimate Ethanol	\$1,596,360	\$1,596,360	\$394,301	\$438,999	(2) VS-5-80 120,000#/hr 250psig Sat.
558	Plainview Bio Ener	\$3,065,400	\$3,065,400	\$757,154	\$842,985	(2) VS-6-92 150,000#/hr 250psig Sat.
559	Kansas Ethanol	\$1,665,160	\$1,665,160	\$411,295	\$457,919	(1) VS-6-92 150,000#/hr 250psig Sat.
562	Northeast Bio	\$1,983,045	\$1,983,045	\$489,812	\$545,337	(2) VS-5-80 120,000#/hr 250psig Sat.
576	Temple University	\$2,049,079	\$2,035,055	\$502,659	\$559,640	(3) VS-4-68 75,000#/hr 250psig Sat.
Total	Unshipped			\$9,639,230	\$10,731,937	
Total	Shipped			\$1,165,392	\$1,298,878	
Total	All Units			\$10,804,622	\$12,030,815	